IN THE UNITED STATES DISTRICT COURT
OF WESTERN PENNSYLVANIA

THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF ALLEGHENY HEALTH, EDUCATION AND RESEARCH FOUNDATION,

Plaintiff,

vs.

PRICEWATERHOUSE COOPERS, LLP.,

Defendant.

CIVIL DIVISION

No. 00-684

Transcript of SUMMARY JUDGMENT ARGUMENT
commencing on NOVEMBER 13, 2006
United States District Court, Pittsburgh, Pennsylvania
BEFORE: HONORABLE DAVID S. CERCONE, DISTRICT JUDGE

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P R O C E E D I N G S

(November 13, 2006. In open court.)

THE COURT: This is the time set for argument on motions for summary judgment filed in the case of The Official Committee of Unsecured Creditors of Allegheny County Health, Education and Research Foundation, plaintiff, versus PricewaterhouseCoopers, defendant.

The Court's understanding is that Mr. Rafferty is going to be arguing on behalf of the defendant.

MR. RAFFERTY: Yes, Your Honor.

THE COURT: Are you ready to proceed, sir?

MR. RAFFERTY: Thank you, Your Honor.

Your Honor, before I start, let me say that if I have to stop occasionally, it's because having young children at home, they bring everything home with them.

THE COURT: I understand.

MR. RAFFERTY: Your Honor, I'd like to start with a point that I think sometimes gets lost in this case, and that is exactly who is who here.

This is a case brought by the Committee, but they are bringing it pursuant to 11 USC 541. They, in effect, stand in the shoes of AHERF. As the Court in Lafferty says, and as the statute itself says, they have whatever rights AHERF had on the day AHERF filed for bankruptcy vis-a-vis Coopers & Lybrand, now the successor

firm PricewaterhouseCoopers. They don't have any more rights than they had on that day. They don't have any less.

The corollary to that is that PricewaterhouseCoopers has available to it every defense that it could have raised had AHERF sued Coopers & Lybrand on the day that it filed bankruptcy.

So the way Section 541 works is Mr. Whitney and his clients are standing in the shoes of AHERF, and they are subject to whatever defenses this defendant could have raised against AHERF, and they cannot be in a better position by virtue of the bankruptcy than they would have been had AHERF survived and brought the lawsuit on its own.

Now, this has been a very long case. The bankruptcy was filed in July of 1998. There were disclosures given to the trustee in the bankruptcy proceeding pursuant to Bankruptcy Rule 2004, including things such as all the work papers of Coopers & Lybrand relating to this audit.

This is a case where discovery effectively started years and years ago. There has been something on the order of 200 depositions in this case, and discovery is now over. Now is the time if there are material facts in dispute with respect to the issues raised in our motion, it's incumbent upon the plaintiff to come forward with

them.

They don't get to say it's a complicated mess and we don't have to point out the disputed material facts. We can just say let's save it for a trial.

Now, our motion has effectively three major components. There are some smaller challenges to specific claims as to the legal sufficiency of those claims, but there are three principle issues that I think I'd like to spend most of my time on today with the Court's indulgence and patience.

The first is the audit interference of AHERF which bars their claims. When a client interferes with the auditor's ability to perform its work, that raises a defense of contributory negligence. In this matter, Your Honor, we're only talking about economic losses here, and because of the economic losses being the only damages being sought, if AHERF itself contributed to the audit failure by interfering with the audit, their claims are barred. They are cut off. It doesn't matter. It's the Committee.

As I said when I started, they are standing in AHERF's shoes, and they are subject to any defense we could have raised against AHERF.

THE COURT: I find it interesting in your brief as I was reading it on the beach in Naples, Florida, last week -- I hate to rub it in -- but I find it very

interesting your position is comparative negligence doesn't apply to this case.

MR. RAFFERTY: That's right. These are economic losses, not personal injury property damage.

THE COURT: Common law contributory negligence.

MR. RAFFERTY: There is an absolute bar to the extent they interfered. Now, in fairness, Your Honor, if they were negligent and contributed to their own injury, but the negligence was simply, for example, mismanaging the business, that would not provide a contributory negligence bar for an auditor. There must be some nexus between the conduct, the negligent conduct of the clients and the audit. It has to be interference with the audit. The Jewel court case makes that clear.

But we have a somewhat different view on what the interference has to be. I mean it has to be a substantial factor, indeed, but substantial factor simply means there has to be a nexus.

There could be other factors. There could be a hundred reasons why these debtors failed that are separate and apart from the audit, but if the audit interference was a substantial factor, then we're entitled to the bar of contributory negligence.

I'm going to come very briefly, Your Honor, to

the facts relating to that, and part of what I want to do today is I want to describe to Your Honor this is not just negligence on the part of AHERF. AHERF intentionally, intentionally and repeatedly interfered with the audit performed by Coopers & Lybrand.

The second basis of our motion, Your Honor, is the defense of in pari delicto, which flows from the Third Circuit decisions in Lafferty and Cendant. We believe the Third Circuit decision in Lafferty, in particular, bars all of the claims here and entitles PricewaterhouseCoopers to judgment.

Now, those two motions were raised on our initial briefing in this case, and following our initial briefing in this case, the Third Circuit decided the CitX case. We believe that the CitX case provides an independent basis, putting aside audit interference, putting aside in pari delicto, putting aside other legal challenges to the legal sufficiency of this case, the CitX case bars these claims as a matter of law.

I'm prepared to proceed whichever way Your Honor wants me to. I can start with the CitX case or start with the motion we filed, which is equally valid today as the day we filed it.

THE COURT: You may feel uncomfortable with this, but let me ask you. Which of the three arguments do

you believe is your strongest?

MR. RAFFERTY: Your Honor, I believe the CitX decision is the simplest. It is the cleanest, and it is far and away -- I don't have to wander through some of the undisputed facts as I will have to do with audit interference and as I will have to do with in pari delicto.

CitX, I can address my position on CitX in basically five minutes. If the Court is interested in proceeding that way, I'm happy to turn to the back of my book and --

THE COURT: That's fine. It really doesn't matter. Whatever is easiest for you.

MR. RAFFERTY: I'm here to assist you.

THE COURT: Then begin with the CitX case.

MR. RAFFERTY: There are three causes of action. Count 1, professional negligence; Count 2 is breach of contract; Count 3 is for aiding and abetting breach of fiduciary duty by certain of the management of AHERF.

All of the claims flow from the same factual basis. All of the claims in the complaint incorporate by reference all of the paragraphs that previously came before. They all have the same theory of causation, Your Honor.

The theory of causation, and I'm sure

Mr. Whitney will do this more eloquently than I can, as I understand the theory of causation, if Coopers & Lybrand had reached different conclusions about the financial statements prepared by AHERF and its management in 1996 and 1997, they would have been obliged under the existing standards to raise those issues with the audit committee, and the audit committee and maybe the creditors if they had been told that things weren't what they seemed, this was not a healthy institution, that it was careening towards a bankruptcy, that they would have taken some steps to turn it around and fix the problem.

That is, as I understand it, their theory of causation. It is their theory of causation for all three counts by failing to do that, Coopers engaged in professional negligence; by failing to do that, Coopers breached their contract; and by failing to do that, Coopers aided and abetted the management of the company who had fiduciary duties to AHERF and who, according to the plaintiff, breached those duties.

Now, the interesting thing is not only did they have the same factual basis, the same theory of causation, but they seek precisely the same amount of damages for each count, with one very minor exception.

What they seek, Your Honor, according to the amended complaint, and this is at Paragraphs 49, 57, and

63, they seek the full extent of debtor's insolvency.

Now, with respect to the aiding and abetting claim, they not only seek that in Paragraph 63, but they added Paragraph 64 that says plus punitive damages on top. They are asking for the full extent of the insolvency. Every dollar that is owed to a creditor they don't have to pay, they want PricewaterhouseCoopers to pay.

Now, their experts have come up with two theories of damages that they've presented in this case, and those motions aren't on today, but I'm just going to briefly touch on them. They have a big theory, a very, very big theory of damages that they call the total creditors' shortfall. That's for some $557 million, and then they have a subset of that which they refer to as the avoidable losses, and that number is two hundred sixty-seven and a half million dollars; and they're asking for those numbers in the alternative. As I understand it, the 267 is a component of the bigger number.

Now, Your Honor, in my view, the second number of avoidable loss is perfectly analogous to the deepening insolvency theory of damages. It is if you had done what you were supposed to do, we would have fixed this, and we wouldn't have gotten further. We would have avoided those other losses which we contend were avoidable. There are lots of fact questions as to whether they were avoidable.

That's not an issue we have to decide now. If we ever have a trial, they'll put on their evidence, and we'll try to rebut it. The bigger number is not only deepening insolvency, it's the total insolvency. It's the total creditor shortfall.

Now, against that background, CitX has two expressed holdings, and the plaintiff in its brief talks about lots of things, but it tries to avoid the two expressed holdings.

The two expressed holdings in CitX are as follows: The first is that deepening insolvency is not a valid measure of damages for any claim, for any claim at all. The Third Circuit says that as loud and as clearly as you can say it. They say this requires us to decide whether the deepening insolvency is a viable theory of damages for negligence as opposed to whether it's a viable cause of action, and they deal with that in their second expressed holding.

They come up with saying that no one should read Lafferty, the Third Circuit decision in Lafferty, no one should read Lafferty as creating a novel theory of damages for independent causes of action called deepening insolvency.

Interestingly enough, Your Honor, one of the judges who was on the CitX panel is the author of the

Lafferty decision. So this wasn't just a different panel that went at it from a different direction --

THE COURT: Who was that?

MR. RAFFERTY: Judge Fuentes sat on both panels and wrote the decision in Lafferty and joined in the decision presumably here.

Your Honor, now, the second expressed holding in this decision, and they're pretty simple to find in the case. There are two clear holdings. The first one says it's not a theory of damages. The second one says that claims for deepening insolvency are claims that sound in fraud. They cannot be negligence claims.

What they say is in Lafferty, Lafferty was a situation in which a company was -- a series of companies were created, and they were essentially shells, and they were run to bilk investors.

The question in Lafferty was whether extending the corporate life of those entities by participating in this fraud could create a theory of damages, and deepening insolvency in Lafferty was viewed as a cause of action, and that's what the CitX courts say. The claim in Lafferty was under Pennsylvania law a claim for deepening insolvency which requires fraud.

Now, in this case, Your Honor, there is no fraud claim, and the reason I took Your Honor's time to go

through the three counts, at the front end, there is a breach of contract, professional negligence, and anyone aiding and abetting of breach of fiduciary duty not owed by my client but by others. We presumably, according to the plaintiff, helped to breach their duty.

In fact, Your Honor, early in this case, very early in this case, 2002, this plaintiff sought leave to add a count for fraud. Judge Ziegler denied that.

This is what Judge Ziegler said in his Order of the 26th of August 2002. He said it's hereby ordered that plaintiff's motion is denied as untimely -- this is 2002. The bankruptcy was filed in 1998 -- based on previously known facts and prejudice to the defendant.

Well, Your Honor, I submit with due respect, if it was prejudicial to the defendant in 2002 to allow this plaintiff to add a fraud claim, it hasn't gotten any less prejudicial four years later and 200 depositions into it where we were focused on a case that dealt with three counts, and none of which were fraud.

Now, in response to our brief, the plaintiff has said, well, you know that's not consistent with our theory of damages. Well, it absolutely is our view on CitX. The creditor shortfall, the total creditor shortfall is an illegitimate measure of damages either way because it effectively makes the auditor the insurer for the entire

enterprise. Every dollar the enterprise ends up short, the auditor has to come up with.

Deepening insolvency itself, the claim in Lafferty, never contemplated that. It was the deepening part of the insolvency, not the entire insolvency.

Our view is that within these numbers, they've included elements that even if CitX had been decided the other way, even if the Third Circuit had said this is a valid theory of damages and you can proceed on it, even if that happened, some of the numbers in there, their numbers don't belong, but that's an issue for another day that we may never have to get to.

Our position is a pretty simple one. Two holdings. Not a theory of damages, and it's the only kind of damages sought here; and secondly, to the extent that there is such a cause of action under Pennsylvania law, and that's what they decided in Lafferty, that the cause of action requires fraud. It is not negligence based, it's not contract based, it's fraud based.

On that basis, Your Honor, we think that CitX says these three claims seeking these damages on this theory, this set of facts, this theory of causation ought to be dismissed now. They're simply not consistent with the teaching of the Third Circuit in CitX, and unless Your Honor has questions, that's really all I have to say about

CitX.

As I said, I think it's among the more straightforward issues we have to deal with in these motions.

THE COURT: You can proceed.

MR. RAFFERTY: Your Honor, I would like now to jump back to the audit -- well, let me jump back to something else. There's two things I want to say that cover everything that we moved on.

The first is that they all have something in common, and that is they don't involve the issue as to whether or not Coopers performed its 1996 and 1997 audits in accordance with Generally Accepted Auditing Standards or GAAS for short. That's not a basis of our motion.

Those issues are complicated issues. There are lots of disputed material facts about those issues. If there ever were a trial, I think my opponent estimated he would need more than a month to put on his case. I'm sure he'll refine that to some degree.

There are conflicting accounting issues that would have to be resolved. This motion does not involve them. You do not have to decide whether or not Coopers & Lybrand in 1996 and 1997 performed their audits in accordance with GAAS. Nothing in these motions turn on that.

I think this is a pretty critical issue because my suspicion is that the plaintiff is going to take the view that that's the central issue in this dispute and that's what you should be resolving today.

We didn't move on that, Your Honor. We try not to make motions that simply are a waste of the Court's time, and that's what that would have been because there are too many material facts that there is conflicting testimony on, and if there ever was going to be a resolution of those issues, it would require a jury. There is no question about that, but that's not this motion.

Okay. The second thing is this motion is ripe. It is very ripe right now. There's been more than extensive discovery. There's been almost 200 depositions in this case. The case is now heading on to more than half a decade since the case was filed. We're finished with discovery.

Now is the time where if there are material facts that prevent the Court from granting judgment as a matter of law to the defendant, the plaintiff has to come forward with them. They can't -- I will take a minute later on, but in a lot of the findings of fact we put in, their response to it is they don't dispute it now, but, Your Honor, now is the time they have to dispute it.

If they don't dispute it, then it's

undisputed, and Your Honor is entitled to rely on those facts to find for PricewaterhouseCoopers on summary judgment.

The other thing that makes this ripe, Your Honor, and there are many instances, and I'm not going to pick them all out. I don't want to spend a lot of time on it, but where the plaintiff says, well, you know, this needs to be decided at a trial, this needs to be decided at a trial.

I want to take you back to the controlling Third Circuit precedent here, which is Lafferty. Lafferty's procedural posture was a judgment on the pleadings, and what did Lafferty grant judgment on, the pleadings. Lafferty found in pari delicto and granted judgment on the pleadings to the defendant, the one remaining defendant in this case, third party professional on claims of breach of contract, professional negligence, and aiding and abetting breach of fiduciary duty, the same three claims that are here.

It is perfectly clear that to the extent there are undisputed material facts that support our motion, the motion is ripe, and the Court is entitled to grant this judgment, much as the Third Circuit affirmed the judgment in Lafferty.

Now, having said that, let me start with audit

interference. As I said, I'm not going to dispute that the interference has to have been a substantial factor in the auditor's failure. One more thing I do want to say about audit interference, Your Honor. Going back to what I just said about whether or not the audits were GAAS or not in '96 or '97 is irrelevant to this motion. In fact, in the Jewel court case, the Court notes to the extent the jury ultimately finds that the auditor did not engage in negligent conduct, that the audits were not negligent, the question of contributory negligence and audit interference simply passes out of the case.

We all have had that experience. If the jury comes back and answers the question were they negligent and answers no, then you never get to the question of contributory negligence; but here the question of contributory negligence is teed up. There's not only contributory negligence, there's intentional interference with this audit.

Their arguments are this first one that I tried to address, which is because Coopers in their view was also negligent, that the negligence of AHERF should not matter. That's simply not the law as the Jewel court makes clear. In fact, it gets the law exactly reversed.

The second argument is their wrongdoing wasn't substantial enough, and they also say it may have been

unintentional. They also say the audit client didn't have to be forthcoming with the auditor. The auditor is supposed to find it all automatic. You got to assume your client is lying to you.

That's neither the law nor what the accounting standards require. You're required to be skeptical, but being skeptical doesn't mean you should assume your client is lying to you about everything because if that were the case, and this is in the auditing standards, if that were the case, you would have to go back and verify every piece of paper in the company, every book and record to make sure they were genuine and not forgeries and haven't been tampered with. The world would grind to a halt if that was the standard.

Let's go to the facts. Your Honor, in these companies, AHERF and Coopers & Lybrand, they have an agreement, and if I might, Your Honor, if I may approach, I got a book with the actual documents they're going to use and one for your clerk, and I have given Mr. Whitney a copy.

Your Honor, I'll try to move through this as quickly as I can, but there was an engagement letter for each of these two audits, and that is Exhibit 1 in your book, which is the engagement letter for the '97 audit. It's on the letterhead of Coopers & Lybrand, and at the end

of the letter, it is signed by Coopers & Lybrand, and it's signed by Mr. McConnell, who is the chief financial officer or was the chief financial officer there.

Now, Your Honor, let me take you to, and we can put it up on the screen, a paragraph that deals with the representations of management, and it's on Page 6, the bottom of Page 6 in your exhibit.

What this letter says, Your Honor, the agreement, and this, by the way, is the contract that we're being sued on, this says that at the conclusion of the audits, not at the beginning, at the conclusion of the audits, AHERF management will provide to us, meaning Coopers, a representation letter for each respective report that, and then it goes on to say what is going to be in the representation letter. They're going to have to represent that management was responsible for the preparation of the financial statements in accordance with GAP, and there are a variety of other issues that they are then supposed to include in the letter.

Okay. Now, this wasn't a kind of an off the back of the envelope thought. If you go down to the next paragraph, what it says is that in the context of this audit, if there has been -- if a member of AHERF management makes a misrepresentation to Coopers, regardless of whether such person was acting in AHERF's interest, Coopers will be

indemnified.

To be perfectly fair, Judge Ziegler has said that paragraph doesn't prevent Coopers from being sued itself for negligence, but when the parties signed this agreement, they took these representations seriously.

There's a reason for that, Your Honor. If I could ask you to look at Exhibit 3 in your book. We can put it up on the screen as well. This is the governing auditing standards from the American Institute of Certified Public Accountants that were in effect at the time, and this covers these representation letters.

The first thing that is really important about the representation letters is that they are absolutely required -- this isn't sort of an afterthought -- the standards say it is a requirement that the independent auditor obtain written representations from management as a part of an audit performed in accordance with Generally Accepted Auditing Standards and provide guidance concerning the representations to be obtained.

If you turn to the next page, there is a laundry list that goes over onto the third page A through T of the variety of subjects that if appropriate, need to be included in the letter.

Now, I suspect Mr. Whitney is going to tell you these letters were drafted by Coopers and given to

AHERF to sign.

That's true. No dispute about that. And the reason for that, Your Honor, is that the auditor has to get a letter that satisfies this standard. It can't take the chance that the client is going to write something that is a little bit different or ambiguous. It has to meet the standard.

There's a consequence if you can't get this representation, and this is one of the things I'm going to come back to, why what happened here is audit interference, the likes of which I have never seen, and I have been doing this for a while.

What happens if you don't get such a letter. The standards tell you that, too, in Section 11 on scope limitations. The standards say that management's refusal to furnish written representations constitute a limitation on the scope of the audit sufficient to preclude an unqualified opinion.

Put into my simple English, if you don't sign such a letter and make those representations, AHERF, we, the auditors, cannot give you a clean or unqualified audit opinion on your financial statements. Remember, this is at the conclusion of the audit. Management has to come in and make these reps, otherwise, there is no opinion.

Your Honor, I submit to you that had there

been no unqualified audit opinion in '96 and '97, I wouldn't be having this conversation with the Court today. We wouldn't be here.

So what happened? What happened, Your Honor, is they lied to us. They lied to us intentionally and knowingly.

Now, Your Honor, this is probably the first time in a summary judgment argument that I have ever used video depositions. I think it's kind of unusual, but this, as I said, is the most --

THE COURT: This is the first time I ever had it presented in an oral argument.

MR. RAFFERTY: It's a first for both of us, and I struggled with this. The reason for this is I want you to see the words come out of the mouths of these witnesses.

The witnesses you are going to see were senior management at AHERF, among the signatories on the letter. The letter is at Exhibit 2 for 1997, and the letter is signed by Mr. Abdelhak, the chief executive officer; by Mr. McConnell, chief financial officer; by Ms. Wynstra, who was then the general counsel; and in '97 by Al Adamczak, who was vice president in charge of corporate support services, which effectively is like the controller. The four of them signed it, not just one of them.

We have a small problem in this case. Unfortunately, Ms. Wynstra is deceased. Mr. Abdelhak and Mr. McConnell, they won't tell us anything. They have both taken the Fifth, and they are not answering the questions.

The reason I wanted you to see Mr. Adamczak and even Mr. Cancelmi, they have testified. They didn't take the Fifth, and they both said that when they signed the letter, they knew it wasn't true.

THE COURT: What happened on the criminal charges that were brought?

MR. RAFFERTY: Some of them were dropped, and some of them were resolved.

THE COURT: I may have known at one time, but were there convictions?

MR. RAFFERTY: No, I don't believe there were any convictions.

THE COURT: Since we are talking about the status of these individuals.

MR. McDONOUGH: Ms. Wynstra passed away during the course of the criminal proceedings, and Mr. McConnell entered into a plea agreement that required some community service with respect to a small fraction of the charges, and Mr. Abdelhak entered into a plea agreement as well, which included some halfway house or house arrest time, I think, of a couple months, and that was the conclusion.

There were no trials.

THE COURT: I didn't ask if there were trials. There were convictions or they pled guilty or convictions or they went through the ARD program.

MR. McDONOUGH: I know Mr. McConnell went through the ARD program, and I don't believe Mr. Abdelhak's conviction was an eligible offense. He served a little time.

THE COURT: Thank you.

MR. RAFFERTY: Your Honor, going back to the letter. The reason for showing you some of this deposition testimony is both these gentlemen say they signed the letter, we knew it wasn't true, we signed it anyway. We gave it to you.

At the end of the audit, they signed a letter that included representations about various things that are actually at issue in this case, including the overall thing, were the financial statements in accordance with GAP when they knew they weren't. They knew that Coopers & Lybrand wasn't going to catch it now. They hadn't caught it before, and it was the end of the audit.

We are going to take a few minutes after this to say how it is they managed to put this one past. They lied about this. Let me show you what Mr. Adamczak said, and, Your Honor, we have given you the written testimony at

Tab 4 of your book as well.

THE COURT: I see it.

(Whereupon, an excerpt of the videotaped deposition testimony of Mr. Al Adamczak was viewed by the Court.)

MR. RAFFERTY: Your Honor, he lied. He signed the letter, gave a rep. letter, and Mr. Adamczak and Spargo and Mr. Cancelmi, the people's depositions which I might get to today in brief snippets like this, were all certified public accountants. They understood what the standard was. He testified he knew Coopers was entitled to rely on this letter, and he lied.

Now, I'm not going to keep playing it because it will take too long. In the excerpt I have given you Page 908 of his transcript, which is at Tab 4, the question was asked, and is it the case that you did not tell anyone from Coopers & Lybrand that you believed any of the statements in the representation letter marked as Exhibit 1626 were inaccurate, and the answer is that's true.

He didn't tell Coopers. He gave us a representation letter that he signed and that his senior management signed, and he knew when he gave it to us it wasn't true.

He also knew being a certified public accountant, Your Honor, that if he had come to us, just

roll the clock back and imagine the hypothetical. Suppose he had said I'm not signing it. If he hadn't signed it, the auditing standards say we couldn't have given him an unqualified auditing opinion.

He could have also said, you know, there are things in here I'm not comfortable with. We got to change them. Something else would have happened, but none of that happened. He simply signed it, handed it to us, didn't tell us about it, and he lied. That's audit interference. That's not negligent audit interference. That's intentional conduct.

He testified that he knew totally that when he signed the letter, that he was signing something that wasn't true. That's intentional interference with the audit. Because had he refused to sign it, there wouldn't have been an unqualified opinion.

That is a substantial factor in the reasons that we're here today in the injury to AHERF that they allege came from not properly auditing the financial statements. He could have told us what was wrong. He knew, but he didn't, and instead he lied.

Now, Your Honor, we have exactly the same language in the contract for 1996, which is at Exhibit 12. The representation from management is the same. The indemnity is the same. The same standards applied to the

'96 audit, and Exhibit 13 is a 1996 management representation letter. This one was not signed by Mr. Adamczak. It was signed instead by a gentleman named Mr. Spargo. I will show you a very brief clip of Mr. Spargo because he, too, lied.

(Whereupon, an excerpt of the videotaped deposition testimony of Mr. Spargo was viewed by the Court.)

MR. RAFFERTY: Your Honor, he signed the letter, a rep. letter. He is a certified -- he was a certified public accountant. He knew what the rep. letter meant. He knew without a rep. letter from management, at the conclusion of the audit, there could be no unqualified audit opinion.

He knew that the debt reserves, which are in issue in this case -- if we ever had to try the negligence part of this case, one of the issues is going to be the reserves, one of the key issues, and the transfers of reserves among various of these entities.

So there can't be, Your Honor, any clearer indication of interference with an audit than affirmatively misleading the auditors at the conclusion of the audit.

You know, he said the ball was in somebody else's court. He already knew they were at the end of the audit. This is essentially in the process of things among

the last steps. That's what the standard says. At the conclusion of the audit. That's what the agreement said.

So, Your Honor, I'm looking at the time, and I'm not going to go through all of these. I want to touch on the highlights. They had things called X files, internal files that listed some of these reserves and shortfalls that they never shared with Coopers.

What the plaintiff says in response to our finding of fact is that they didn't provide the X files -- X files, Your Honor, was their name. I was going to show you testimony of one of their witnesses describing how he recalled they came up with the name. He didn't remember if it was from the television show or meant excess.

They were effectively cushions they could move around, which is not in accordance with GAP. What they do is they deny. They say, Spargo, Mr. Spargo testified he recalled sharing and discussing the X files, but he never remembered -- he was never able to say who he gave them to, when they were given to him, and Mr. Lisman, the man who prepared the X files, testified that he never provided them, that he didn't recall ever being asked to give them to Coopers.

We can play Mr. Lisman's testimony. He is one of the creators of the X files.

(Whereupon, an excerpt of the videotaped

deposition testimony of Charles Lisman, Jr., was viewed by the Court.)

MR. RAFFERTY: Your Honor, he doesn't recall giving it to Coopers. He doesn't recall giving it to anybody but Mr. Cancelmi, who was a CPA that worked inside of AHERF.

The X files are at Tab 6 of your book. There are documents that are referred to as cheat sheets that tracked reserves and cushions; and they did give us documents that showed the reserves and cushions, but what they did was before they gave them to Coopers, they took the footnotes out, Your Honor, and the footnotes are what showed you what the reserves and cushions actually were.

At Tab 7 in your book is a document that shows the revenue per admission track on a monthly basis. This is an internal AHERF document they didn't give to Coopers, and there are footnotes in that, and you might be able to see the footnotes better on the screen. They are a little bigger.

For two of the months, they include recognition of reserves from Graduate and a $10 million reserve adjustment.

Now, the important thing here, Your Honor, when they track this, they are trying to see whether you are making the same amount of money on admissions every

month. It's a financial management tool.

When they turned this over to Coopers, they didn't give it to them in the form that they had it internally, which showed the impact of the reserves on the numbers, because the two numbers in the column that those footnotes come off are numbers that are very different than the other monthly numbers. One is 17 and one is 19, as opposed to the others, which are all in the 10 to 13 range. So what they did was they gave us instead Tab 8.

Tab 8, which is Exhibit 312. If you turn to the last page of Tab 8, they simply averaged it out for the year. They dropped the months out and dropped the footnotes, and the testimony from the witnesses, which we've included in Your Honor's book as well, indicate that for Mr. Cancelmi -- his testimony is at Tab 9 -- before they provided this schedule to Coopers in an electronic form, they took the footnotes out.

Now, I want to make it clear, because Mr. Whitney is going to do it if I don't do it, could Coopers have found some of these things.

THE COURT: I'm sorry. You said could they have --

MR. RAFFERTY: Found out some of this. The answer to that is absolutely yes. The truth is in the world somewhere, the truth about the finances. With enough

time, with enough money, with enough diligence, you might have uncovered the fraud, the outside auditor.

The outside auditor here wasn't doing a fraud audit. They were doing the normal yearend audit. These people knew what they were doing. They had X files they didn't give us. They had cheat sheets they gave us in a stripped-out form. They simply hid the information, and then they got to the end of the year and the end of the audit and they gave us rep. letters that they now have testified were knowingly false. That's audit interference.

Your Honor, I think I need to move quickly onto the issue of in pari delicto. I just want to say in pari delicto is a theory that requires, unlike audit interference, the imputation of the wrongdoing of AHERF's management to AHERF itself. That's the first step. You have to impute it.

This flows out of the just old standard agency rules we all learned in law school, I'm acting in the scope of my agency, then what I do is attributable to the person for whom I'm acting as agent. It's perfectly clear that in the rep. letters, those people were the agents of AHERF. They were the CEO, CFO, general counsel, and effectively the controller.

As to show what does plaintiff say in response to this. Plaintiff says, well, they were acting aversely

to the interest of AHERF because they wanted to preserve their salaries, emoluments, the luxury lifestyle. They got used to the corporate jet retreats.

I don't think under the Cendent decision that those issues get plaintiff to a finding as a matter of law of an adverse interest. I don't believe that it's enough.

There is an earlier decision by Judge Ziegler in that he denied summary judgment in another case in which he was moved by some of those same facts, but I think the Third Circuit has made pretty clear in Cendent, it doesn't really matter if the wrongdoers are feathering their nest at the same time they're acting within the apparent and actual scope of their authority on behalf of the company.

But even if that were the case, Your Honor, even if the adverse interest doctrine were to apply here, there is yet an exception to that which is called the sole actor exception to the adverse interest rule. That is when someone so dominates or some group so dominates the company that they control it, that what they do or don't do is imputed to the company because they're the ones who are dominating the company. That's precisely what we have here, Your Honor.

You know you don't really have to take my word for it because in a separate case, this same plaintiff brought a lawsuit against some of the officers and

directors of this company, and what they said in that case was that this management thoroughly dominated this corporation. The management ran roughshod over AHERF, particularly Mr. Abdelhak.

THE COURT: You don't think there's a material issue of fact on that point?

MR. RAFFERTY: No, I don't think so, Your Honor, because if you -- let me go through the testimony very quickly. There's lots of findings in fact in which the plaintiff said we don't dispute. You quoted the testimony right. We don't think you should get the inference from it. Many of the trustees, Mr. Abdelhak ran this company as a fiefdom.

THE COURT: I read those.

MR. RAFFERTY: In their complaint against, among others, Mr. Abdelhak, they said things -- why don't we put up Paragraph 46.

This is a complaint filed by this plaintiff against, among others, Mr. Abdelhak. One of the things they say in the complaint they filed in court, that Abdelhak was able to cause his managers to allocate expenses and revenues among the various entities in the system simply on the basis of how he wants the entity to look.

Those aren't my words. Those are words this

plaintiff put into a court file.

Now, go back to Paragraph 44. They also said in that same complaint, the lax internal control environment was underscored by the nature of AHERF board meetings, which were short in duration, thoroughly scripted by the office of defendants, with the cooperation and acquiescence of key trustee departments and intentionally designed and conducted so as to discourage meaningful scrutiny by the other members of AHERF's board.

In other words, Your Honor, this plaintiff said these officers, defendants, dominated this company.

Now, there's more than that, Your Honor. There is a very full record at our Finding of Fact 49. We say that there is not a single instance recorded in any of the minutes of the AHERF board of trustees of any trustee dissenting from an action taken by the board.

What does the committee say in response? They say that's right. The available board minutes don't reflect any trustee dissent.

We have Paragraph 44 of our findings. We quote from the testimony of Richard Daniel, the former vice chair and chair credit officer of Mellon Bank. He says Abdelhak was a dominant CEO to the extreme. So he was dominating the board.

Answer: He was dominating every meeting that

I was involved in.

The Committee doesn't dispute this. They say, again, that we accurately quoted from the testimony.

There's more. There's Henry Allen, the retired president and CEO of the Pittsburgh and Lake Erie Railroad, also on the board. He said Mr. Abdelhak ruled with an iron fist and demanded, and in most cases, received from any subboards absolute adherence. We quoted them in the brief.

There is more than ample evidence that Mr. Abdelhak and his inner circle dominated this company and their wrongful conduct. Remember, in this complaint that we went through, this plaintiff filed against Mr. Abdelhak, the complaint said that the action of Mr. Abdelhak and the other defendants in that case caused the downfall of AHERF.

Now, they're not bound by -- you can have many causes for a downfall. I don't dispute that, but they understood that Mr. Abdelhak dominated this company. The evidence is irrefutable saying that we quoted it accurately. You shouldn't draw an inference from it that there was domination.

That's all there is. There is nothing to try here. We're not going to have to sit for months on that question and have these people parade in front of a jury

and say the same thing they said under oath in a deposition. They don't have any facts to the contrary. They don't have a single board minute that reflects a dissenting view taken by a trustee.

There is more than ample evidence that the wrongful conduct of Mr. Abdelhak and Mr. McConnell and others is imputable and should be imputed to AHERF, much like the Third Circuit did in Lafferty; and once that conduct is imputed, Your Honor, the claims here fall away.

I want to go back to where I started on this. Remember this isn't -- the plaintiff here is only nominally the creditors' committee. The plaintiff, the actual plaintiff here, the person or the entity whose rights are being enforced against Coopers and PwC as successor is AHERF. It's AHERF. They're standing in AHERF's shoes.

The Third Circuit, the arguments that they make in response to in pari delicto and imputation are all equitable arguments. They were innocent trustees. The Third Circuit rejected that. They were innocent board of directors in Lafferty as well. The Third Circuit said that's not meaningful. You're bound by 541 to the rights that the debtor has of the bankruptcy, and you're subject to whatever defenses a defendant has against that debtor; and for that reason, the in pari delicto defense is an absolute bar.

I'll also go back. In Lafferty, the same three causes of action were barred by in pari delicto. Breach of contract, aiding and abetting breach of fiduciary duty, and professional negligence, among some others, but those three were also in the mix.

You said an hour, and I'm almost there. If I could very quickly, there are some discrete issues. There is a claim that is not a small claim. It's for a hundred million dollars or so involving the Centennial entities which were in a post-petition consolidation in the bankruptcy and put into this estate for the benefit of creditors, and they're claiming that they're going to recover this money on behalf of them, notwithstanding the fact it's a post petition.

Your Honor, it's really a simple answer. Section 541, 11 USC 541 says you got whatever rights and causes of action the debtor has on the day the bankruptcy was filed. The filing was July 21, 1998. Consolidation was December 14, 2000. There is no Centennial claim in this case. There can't be. Section 541 bars that.

There is also a breach of contract claim that is, very quickly, when we had previously moved against this claim in front of Judge Ziegler, we thought it was entirely duplicative of the professional negligence claim.

At that time the plaintiff said no, there may

well be specific contract provisions that were breached in addition to simply not meeting the standards required of you, and Judge Ziegler declined to dismiss it at that stage. He did say you need to come out with a claim that's based on something other than they breached the same standard that applies to their professional negligence claim.

And we have now gotten to the end of the day. They don't have any such claim. The claim they have is by not doing a GAAS audit in '96 and '97, they breached the contract. Judge Ziegler already decided that. That was back in January of 2003. It's law of the case here.

They haven't got any other facts, material or otherwise, to suggest that there are other breaches, and so the contract claim ought to be dismissed. The contract claim, in any event, would be barred by both the audit interference and by the in pari delicto, but standing alone, it ought to go as well.

Finally, Your Honor, there are two other issues. There is an issue of causation. Their whole theory of causation is if we had done a different job, if we would have raised the flag, they would have done something. Maybe and ultimately that something would have succeeded. That's one too many jumps in the causal chain. That's a shoulda, woulda, coulda theories of damages, and

there are no shoulda, woulda, coulda. It can't be by becoming the outside auditor of a company, you become the insurer, and whatever happens to them, you're responsible for.

There is an aiding and abetting breach of fiduciary claim. There are cases all over the lot. The Supreme Court of Pennsylvania has not said there is such a claim under Pennsylvania law. Some federal courts have said well, I think they would, and some federal courts have said I don't think they would.

Some federal courts have said until they do, I'm not going to do anything. We don't think you ought to be in the business of making new law. In any event, the audit interference in pari delicto bars that claim. You may never have to get there. If you do, there is a question as to whether it is, as a matter of law, whatever the facts are, a valid claim or not.

I apologize. I have gone almost an hour. If you have any questions, I will try to answer them quickly.

THE COURT: On the in pari delicto argument, can you elaborate a little bit more on your position with regard to the adverse interest exception to the imputation?

What was the motivation that you think the record supports?

MR. RAFFERTY: I think the records show

Mr. Abdelhak, who dominated this company, thought that bigger was better. He thought that he could buy bankrupt entities or entities that were teetering on the verge of bankruptcy and through better management and some chicanery we didn't know about at the time, he could turn them around and make them profitable.

He thought at the end of the day, the world would come his way and that bigger would be better. He would be positioned in both ends of Pennsylvania, not just in one, and that would be a good thing, and they were in effect buying --

THE COURT: A good thing for AHERF?

MR. RAFFERTY: A very good thing for AHERF. If they had managed to survive, it might well have been a very good thing. They were taking a chance.

Mr. Abdelhak was, if nothing else, apparently a risk taker. He appears to have been taking a risk here. He was betting on his own judgment that bigger was better and that he could turn things around that other people had failed at.

Ultimately, that didn't come to pass. He ran out of time, he ran out of cash, and he couldn't do it; but I don't believe that he was acting adverse to AHERF's interests as he perceived his interest.

That is the difficult issue in this. In

hindsight, you could say, well, sure, if he hadn't bought that and if he hadn't bought that or assigned that debt, the entity itself would have been in a much better place. That's Monday morning quarterbacking. That's very easy.

Mr. Abdelhak and others were on the ground making decisions on the fly.

THE COURT: What if the facts in the case show a little bit of each, a little bit of the actions taken, the disingenuous actions taken were to expand AHERF, to make it into a real powerhouse and also to personally benefit the alleged wrongdoers?

MR. RAFFERTY: Then you go back to Cendent. Cendent says if they're acting in the scope of their authority, it doesn't matter if they are also feathering their own nest.

I have a really simple mind, but if your salary, if the benefits you get from your job, if the lifestyle you get from going to work and getting a paycheck were sufficient to put you adverse to your employer, then every one of us would in some way be adverse to our employers.

This was not the only company in the United States that had a corporate jet that went on retreats, that paid executives better than maybe they would have been at some other public institutions. It can't be those facts

alone.

They don't have any facts that say, for example, that they took on -- they went out and raised money and they deposited it themselves.

There's an argument at the end of the day they moved some of the retirement funds on the way out the door as they knew the end was coming, that Mr. Abdelhak and others managed to get out of the building with their retirement funds, but at the time that they were making these decisions, I think it's implausible to conclude they were simply thinking this is all a ruse, it's not in AHERF's interest. The whole thing is going to collapse.

I think they sincerely believed bigger is better, and they could turn these things around, and at the end of the day, they would be heroes. Unfortunately, life doesn't work out that way for us. Sometimes you make a bet, and it doesn't come home.

That's what happened here. If you say okay, they were acting adversely, the domination that this gentleman and his cronies had over this company is an exception to that rule. It is the same exception that was applied in Lafferty.

In Lafferty, the Court concluded that they weren't acting in the interest of the companies because the companies were actually shells that were just pass-throughs

to get money.

The Walnut and Creek Lifting Company I think was the name of it, where the Court nonetheless concluded because the Shapiro family dominated that company, their conduct had to be imputed to it.

Either way, I think you can go either way here. You can simply say they don't have enough facts to demonstrate adverse interest, but even if they did, there is more than adequate domination to invoke the sole actor exception to the adverse interest rule. On either basis, the in pari delicto defense would bar this entire case.

THE COURT: Thank you.

MR. RAFFERTY: Thank you very much, Your Honor.

THE COURT: You're welcome. Mr. Whitney.

MR. WHITNEY: Good morning, Your Honor.

THE COURT: Good morning, Mr. Whitney.

MR. WHITNEY: I'm Dick Whitney. I represent AHERF in this case.

I was thinking of some pithy introduction to my argument that I could give the Court, and I kept coming back to something that is not a particularly pithy introduction, but it wouldn't go away, and that is when one considers the couple or several trans files that were shipped over here by the parties in connection with this

motion for summary judgment, and on the basis of my, what is it now, 33 years of experience, something just tells me this is not a summary judgment motion.

What I thought I'd do is I'd suggest to the Court that as the Court knows, this seems to be something that lawyers do nowadays is file these motions for summary judgment in which they're just inviting submissions of all of this testimony, and here's why they do it; but after 33 years, I must confess to you, I don't know why someone does this.

There's no rule of law in Rule 56 that says that if you need a mid-sized pickup truck to bring the entire record over that the Court is supposed to be looking through in support of the notion that there's no genuine dispute of material fact, because that's what all these documents are there to do, there's no rule that says that a mid-sized pickup or higher is a fortiori denial of motion.

As I said, something keeps telling me that, and the more I thought about it and the more I felt like as I'm reading these briefs, and they are really kind of fascinating briefs, it came to me that those trans files aren't indicative of what this thing is really about.

The arguments and counter arguments that are made in these briefs are not arguments in support of a motion for summary judgment. They constitute closing

arguments to the jury on three issues that are by every court that decides them factually intensive issues that raise jury questions.

The reason why they are jury questions is not just because there's inevitably a factual controversy with respect to them, but because if you're talking about in pari delicto or audit interference or proximate causation, sooner or later somebody's got to draw an inference from all of these facts because it isn't as though there is going to be direct testimony that takes you right to it.

That inference is supposed to be drawn by juries, and that is, in essence, what these arguments pro and con are about; and in order to make it appear as though it's a summary judgment case, in each of those three settings, in pari delicto, audit interference, proximate causation, what Coopers does is they articulated at the outset a rule of law that they say is the applicable rule that the Court is to be guided by, that is a rule of law that is so strict that not for nothing, no plaintiff could probably meet it.

And then they argue that, in fact, we didn't meet it, and they state some facts in their favor that they say we didn't dispute and, therefore, voila, one has a summary judgment.

The fact of the matter is in each one of those

cases, the rule of law that they are citing is not correct, and that the case law that does inform these issues invariably says that what we're dealing with here is an issue of fact.

Now, I will get to the CitX case in a little while. I wanted to talk first, though, about in pari delicto, audit interference, and proximate causation, because unlike the holding in CitX, those are the issues that they filed a motion for summary judgment on.

CitX informs a rather different motion that they filed, which they allude to in a footnote of their supplemental brief, which has nothing to do with any of the grounds in their motion for summary judgment, and I'll get to that, if I may -- well, I'll say a minute, but it will be probably more than that.

With regard to imputation and this whole question of adverse interest, the rule of law they come up with is that in order to sustain a claim that AHERF's management was acting with adverse interest, we must show that they totally abandoned AHERF's interests. They acted totally in their own interests. There's something that they inject in their reply brief about the need for the motives to be secret, and mixed motives are not sufficient.

Their undisputed evidence is that we cannot establish this adverse interest comes in the form of

comments like Abdelhak cared deeply about AHERF. Abdelhak and McConnell always acted in the best interest of AHERF. The problem is that those comments don't have anything to do with the management wrongdoing that they are trying to impute onto AHERF; and moreover, the rule of law that they're citing, which is the supposed adverse interest, is not, in fact, the rule of law.

The misconduct they want to impute is stated in their brief. It is undisputed that AHERF's management deliberately recorded the entries that caused the alleged misstatements in AHERF's financial statements, which they prepared. Thus, if the Court imputes the conduct of AHERF's management to AHERF, the committee action fails as a matter of law.

Now, I for one was really impressed with Mr. Rafferty's Kumbaya comments about why Mr. Abdelhak believed in his heart of hearts that the worm would turn and the company would turn around and so forth; but in connection with the in pari delicto argument, he is arguing they cooked the books, and that's what he says, and that's what he did.

Not for nothing the evidence in this case is Coopers was right in there cooking the books with them. Make no mistake about it, this is going to be a fun trial because Coopers & Lybrand is not some lanny-pie (phonetic)

here that was somehow interfered with in their best efforts to uncover the truth.

They were people who absolutely knew every essential element of these book cookings, and that is scattered throughout our statements of fact, but I will allude to some of that today.

With regard to what the standard is, the standard I submit is Judge Ziegler's opinion in the Phar-Mor case. The reason it is is because here you have an effort to try to wrestle with a doctrine of imputation in the context of what we are talking about here, which is a business failure case involving a litigation against the outside auditor and the issue of whether or not a management's wrongdoing or fraud is to be imputed so as to defeat the action.

And what Judge Ziegler had to say there was that we hold that genuine issues of material fact preclude the entry of summary judgment. From the evidence of record, we cannot conclude, as a matter of law, that the fraudulent acts of Monus, Finn, and others were intended to benefit Phar-Mor.

While we recognize Finn, Walley, and Cherelstein have all said that the motivation behind the fraud and the resultant cover-up was to provide time for management to resolve Phar-Mor's underlying business

problems, such a motivation does not, in our judgment, necessarily equate to a finding that fraudulent actors intended to benefit Phar-Mor.

Rather or indeed, a reasonable trier of fact could conclude that the true motive of the wrongdoing was the preservation of their employment, salaries, emoluments and representations, as well as their liberty at the expense of Phar-Mor's corporate well-being.

In other words, the fact that somebody may suggest that there is something out there that might have benefited AHERF, Phar-Mor in that case, the fact that the jury could conclude, that the jury could draw an inference from all of the evidence, theirs and ours, that the true motive was feathering their own nest.

And that is exactly what we have in AHERF. As a matter of fact, AHERF is probably a stronger case than Phar-Mor for the propositions that Judge Ziegler is sitting here. No. 1, Mickey Monus and his friends were saying in Phar-Mor we did it all for the good of the corporation. These guys are pleading the Fifth Amendment.

I mean that is not exactly something that lends itself to an inference that they were doing something for the good of their principle under the doctrine of imputation.

Secondly, this case is more about preservation

of salary and emoluments and jet planes. We're talking here about compensation packages for Abdelhak and McConnell that were substantial and substantially driven by bonuses and incentive compensation packages tracking directly to the company's financial statements and their well-being.

In fact, in our statements of fact, we point out that in several years, the financial statements happened to track almost exactly the targets in those financial packages.

We submit under the doctrine or under the case law of Phar-Mor or under the standard that is set by Phar-Mor, we are dealing here with a jury question that goes exactly to that point.

Let me say a couple other things. One is while the jury is parsing this out, another fact that they could infer motive from or whether benefit derives from this action is that this supposedly dominated board, these lapdogs of Mr. Abdelhak, when they found out about the financial misstatements, they fired him shortly after they fired Coopers & Lybrand. So that the board by its own actions demonstrates exactly what good all of this misbehavior had to AHERF.

In response to that, when we get to the reply brief, we hear, as we heard today, Cendant. The Third Circuit decision in Cendant apparently before Lafferty, the

Third Circuit hasn't decided another case, and in their reply brief they suggest that Cendant effectively rejects this notion of salaries and emoluments and mixed motives and that Phar-Mor is not good law in light of Cendant.

When Mr. Rafferty was talking about a prior summary judgment opinion of Judge Ziegler, I was thinking he might be talking about his prior summary judgment opinion in this case, because apropos of the issue or doctrine of law of the case, Judge Ziegler in his January 2002 summary judgment opinion specifically said that Cendant doesn't change Pennsylvania law on imputation because this very argument about Cendant that pops up in the reply brief is an argument that they already made and lost to Judge Ziegler in connection with the motion decided in January of 2002.

So what starts out as an alleged absence of material dispute of fact in pari delicto, not mentioning and discussing at all Phar-Mor, becomes a reversion back to well, Phar-Mor is not good law. It's all about Cendant. You can't have mixed motive. It has to be a sole motive and so forth.

Judge Ziegler even quotes that argument of theirs in his summary judgment opinion. It is exactly the way it appears in the reply brief down to the inner delineation of the applicable word. I'm looking for the

quote here. While we recognize that Finn, Walley, and Cherelstein have all testified of the motivation behind the fraud and resultant cover-up, the creditors quoting defendant argues that the fraud was committed during the course of senior management's employment.

The second prong of the imputation test is also satisfied because the creditors committee does not even allege that AHERF senior officers were acting entirely, underlined, for their own benefit in committing the fraud.

Judge Ziegler already decided this issue. He already decided specifically the question of whether or not Cendant even addressed the Phar-Mor decision because as we point out in a rejoinder brief, it didn't.

Not for nothing I suppose that Cendant was interpreting New Jersey law on imputation, and the New Jersey Supreme Court ruled, I guess, just a couple of months ago, that the doctrine of imputation has no application, or in pari delicto has no application in a case involving auditor malpractice. That case is called NCP Litigation Trust versus KPMG, 901 A.2d 871.

They have a different interpretation of it, I'm sure, but I don't believe the case would support a differing interpretation.

They then argue that even if there is an

adverse interest, this case is subject to the sole actor exception of Lafferty or the sole actor's exception to the adverse interest rule is designed to address a person or small group of people who hold the shares of the company and can effectively control the board and management.

The rationale, as Lafferty puts it, is no one to whom -- that particular agent has no one to whom he can impart his knowledge or from whom he can conceal it.

That book cooking that was going on in AHERF, there weren't any shareholders here. It is a nonprofit company. The people -- the consumers of the cooked books, the patrons in this restaurant is the board of trustees. Those are the people that they were taking all this effort to cook the books for.

To conceal what was going on and to preserve their salaries, their compensation packages, et cetera, because not coincidentally the book cooking went specifically to what Mr. Rafferty was talking about, this whole business about Abdelhak believed that by acquiring companies and through synergies of scale can turn losing hospitals and health care facilities and medical schools into winners.

The book cooking was designed to hide the fact that the first set of acquisitions he made were not turning around, and the turnaround was the justification for the

next set and the next set and the next set. From the standpoint of what could have been a benefit to AHERF, the answer is nothing.

There are some cases out there that talk about the fact well, even if ultimately it led to a corporate's demise, they obtained some kind of short-term benefit out of the misconduct of management. Here there aren't any short-term benefit. All they did was load on more losing companies along the way and paid salaries and target-based incentives to these guys. They got nothing. AHERF itself, the entity got nothing out of this except more losing entities and a larger bankruptcy.

With regard to the whole business of the sole actor exception, it's a large reach to suggest that the factual situation discussed in Lafferty reaches the AHERF situation. This dominated board of lapdogs consisting of CEOs, of places like Mellon Bank, the CFO of USX, these guys are not on the board. They are the audit committee, and the idea these guys are lapdogs is counterintuitive at best; but if there's any question about that, one need only look at their work papers, which are written by people other than the people who are writing about sole actor domination, and what Coopers & Lybrand in its work papers and characterize that the client has to say is this about the lapdogs.

C&L's experience with the individual boards is that they are generally independent of management, extremely qualified and diligent in completing their responsibilities and are cognizant of their actions and the associated impact on the organization's employees, patients, local communities, and society at large.

The audit committee at AHERF is very active and has significant influence in the operations of the organization. They meet with C&L at least two times a year to discuss the audit plan and the audit results. They review the internal audit plan each year and review any significant findings that may arise from their work.

They are recording in their work papers that these guys are to be taken seriously by them, the auditors. They have to answer to them. That's not exactly a dominated group of people.

Lastly, as we say in our brief or talk about in our brief, there is case law that makes clear that imputation doesn't get you all the way there, that actually dismissing Coopers & Lybrand on the basis of imputation requires application of the doctrine of in pari delicto.

In that regard, there is case law that suggests as that NCP case sort of or the result -- the NCP case from New Jersey would recognize, that when a third party has colluded with a corporate agent in the

wrongdoing, they're not entitled to invoke the doctrine of in pari delicto.

There is also case law that we cite that deal with the presence of innocent decision makers as blocking or barring the doctrine of in pari delicto.

Now, in a bout of candor, I'm going to tell you from looking at all this imputation law, I'm having difficulty trying to square all of the cases in all the different ways these courts analyze them. I have difficulty with the idea there is an exception to the rule and then an exception to the exception; but in addition to that, you've got laid on top of that in pari delicto, laid on top of that collusion, innocent decision makers, and I believe fairly what these cases all come down to is essentially this.

If by not invoking the doctrine of imputation, the only benefit is going to go to the very wrongdoers who created the harm, which is the Lafferty situation, then you impute the conduct.

If, however, by invoking imputation, you are either working a harm on innocence or providing an out to someone who was an active participant in the wrongdoing, you don't invoke the doctrine of imputation.

I believe that all of these cases more or less turn on that, and all of these analyses are directed toward

trying to find the answers to those questions.

An adverse interest exception, sole actor rule, the application of in pari delicto, the question of innocent decision makers, which is another side of the adverse interest exception, they are all the same, and ultimately, they are issues for the jury to decide.

The two sides in their brief are not hunting and fishing for undisputed facts. They are giving the Court their position as to the evidence that they call to the fore to prove what they want to prove with regard to the in pari delicto doctrine, and it is ultimately for the jury to decide whether or not that doctrine should apply based upon instructions given by the Court.

The same approach attaches to their audit interference argument. They begin by stating as a rule, the defense has established if the client is not open and forthcoming in respect to the audit, and failure to provide the auditor with pertinent information in the client's possession can itself constitute contributory negligence.

Failure to provide the auditor with pertinent information in the client's possession can itself constitute contributory negligence.

That's kind of a tall order to hear from one of the four largest auditing firms in the country. There's audit interference if the client is not open and

forthcoming, and failure to provide the auditor with pertinent information can constitute contributory negligence.

Now, they don't cite any cases in support of that proposition of law, and that probably ought not to be very surprising because it rather flies in the face of what an auditor is supposed to be doing. Auditors are supposed to be an independent set of eyes on a financial statement.

One of their roles, for example, is to detect fraud. Yet, it becomes an immediate defense to a malpractice case if they can show that there was something that somebody didn't tell them in the course of the audit.

You know, today, they show you the rep. letter, as it's called, I guess the management rep. letter, and Mr. Rafferty confirmed the fact they get them at every audit as a precondition of signing that little clean statement at the end of the financial statement. No rep. letter, no audit.

So if the rep. letter -- if they can prove the rep. letter is wrong, they take a pass on a bad audit.

That's not what the case law says, and as a matter of fact, one of the cases that we cite to the Court dealt specifically with the question of rep. letters.

It was the lower court case in Cendant where the Court said this Court does not agree that CUC's alleged

failure to provide accurate information to Ernst & Young relieved Ernst & Young of its responsibilities under its contract. By the way, this is an indication that other courts have seen this argument before.

I don't do a lot of this work, but I have done some, and a lot of these arguments are pretty familiar to me, too, not only with regard to audit interference, with trotting out the Drabkin case from the DC circuit and so forth.

These arguments move from court to court, and this court is dealing specifically with what we heard this morning. The very duty, and that would be E&Y undertook was to exercise due care and disclose any acts of fraud it uncovered.

Such a promise necessarily requires that it anticipate the possibility that it would receive inaccurate financial information from CUC. In fact, one purpose of the independent audit is to protect a company and its investors from fraud.

Similarly, in the WorldCom case we cite, the auditor must employ professional skepticism and should not be satisfied with less than persuasive evidence because of a belief that management is honest.

Of course, that makes perfect sense. Most of the auditing standards are about the acts and the steps

that one has to take to determine as an independent set of eyes whether or not the representations of management in a financial statement is true, and that's what is said in the audit opinion. In our opinion, these financial statements fairly represent the financial condition of the company.

If you get an automatic pass when somebody does something that is -- when you can find something after the fact that you didn't know about in the course of the audit, that can't be a standard for contributory negligence, and it's not.

The standard is it has to be a -- it has to make a substantial contribution, and in the context of audit interference, that means it has to have a substantial impact on the ability of the auditor to perform the audit.

Because if it's about whether or not management was just contributory negligent in a vacuum, that's just revisiting imputation again. We already know because they told us in connection with the imputation argument Sherif Abdelhak was a fraudfeasor and so was David McConnell.

Everybody who reads the Pittsburgh Post-Gazette, I guess, knows that; but the point is whether or not the things that they're pointing to interfered with their ability to perform the audit.

They aren't just saying in their papers and

can't, well, you know, we got this rep. letter, and listen to what Adamczak says on the television and Spargo says on the television. They were wrong. They also say Coopers knew those rep. letters were wrong.

Let me back up and say audit interference, in any event, is more properly directed to a situation in which the negligence that is being claimed against the auditing firm are acts of omission, which is what I think Mr. Rafferty was suggesting we have here.

That is the idea, and frankly, it's an idea that probably is visited on auditing firms too often, that something bad happens to a company, it goes under, and creators, and in the list of defendants comes the auditor, and the argument that is made is these people did a bad thing, and Abdelhak and AHERF did a bad thing, and while you didn't know about it, you should have designed your audit in such a way you should have uncovered it. You should have caught it as it went by the door.

An audit interference in that context would have relevance if, in fact, you say their inability to uncover it had an impact or was impacted by what management didn't tell them; but when you look at the areas of the audit in their papers in support of this motion they filed, these are not issues that they did not know about or issues where they were materially hampered from finding out about

on their own.

All of these issues are issues where the auditing misconduct of Coopers & Lybrand, alleged by the plaintiff, lacked more of comission than omission, and the notion of audit interference is almost a non sequitur.

THE COURT: Mr. Whitney, you mentioned at the very beginning of your argument that the record shows that C&L knew that AHERF was, I think your words were, cooking the books.

MR. WHITNEY: Yes.

THE COURT: Point me to a few --

MR. WHITNEY: I'm about to do that in connection with audit interference, because these are the things they point out in their brief. These are where they're planting their flags.

It's not as the argument today suggests -- I grant Mr. Rafferty we're talking about a lot of paper here and one hour of argument, but it's not generalized argument about being mislead. It's in specific areas of the audit they are being mislead.

The first of them is, the first one is the bad debt shortfall at the eastern hospitals. Let me lay this out for you.

What I've come to learn from the AHERF case, one of the most significant items on a financial statement

of a hospital are its accounts receivables.

This stuff is always a little dry, but every now and then you find a kernel of something interesting. Hospitals get their money from patient revenue. There's three kinds of payers. There's the self-insureds or people who don't have insurance, there are people with private insurance, and then there are people with Medicare and Medicaid.

Because of those differences, how much people pay and how much insurance companies pay have a significant impact on whether or not those accounts receivables will ultimately materialize into cash; and for that reason, an enormous red flag on a health care financial statement is the reserve for bad debt, because that is the allowance for how much of that you're not going to collect.

Now, to prove that I'm the dumbest person in the room, when I took accounting for lawyers, you see that number up there in the balance sheet and it's in parentheses, you say okay, I understand that. What I never really understood is you got to get it there, which is to say when you are putting -- I'm smiling. I didn't know this -- when you are putting in your annual statement of operations what your income is in terms of your patient revenues, you got to charge an expense for bad debt off that revenue.

The revenue goes up into accounts receivable. The bad debt expense you take goes up into the allowance for doubtful accounts in the balance sheet. This becomes like really important because this is an area that is a red flag area. It's an area where because bad debt write-offs or bad debt expense is an estimation like most estimations, the accounting industry recognizes the possibility of misstatement is high, and, therefore, it's an area where somebody seeking to improve the appearance of the financial statement can get some sort of short-term leap by basically underestimating for bad debt; but sooner or later, the piper has to get paid, because sooner or later, you got to decide what you're going to do about that accounts receivable.

Because once it gets to be about 12 or 14 months old or 24 months old, it starts to smell a little bit like three-day old fish in a grocery bag, and you got to kill the metaphor fish or cut bait. You got to write it off.

When you write it off, you got to charge it off to bad debt. If you want to write off $10 million of accounts receivable, you got to write off $10 million of that reserve you created by bad debt expense to do it.

This is what AHERF's problem was in 1996, which is the primary audit under review here, and that is

they had been under reserving for bad debt. They had been under expensing in the financial statements for bad debt.

Coopers & Lybrand said there is audit interference here because they found a memo from an in-house accounting guy, a CPA they point out, that notes in September of 1996, after the close of their fiscal 1996 audit year, which ends at the end of June, and the audit ends in September or the audit report is typically due at the end of September, they found out that he is recognizing in this memo, and you heard it also in the video played, they knew that they were under reserved for bad debt.

The only way you can fix that, at least the only valid way you can fix that is to take a substantial bad debt write-off, but what AHERF also did, and it's apropos of these X files, is they used to engage in something else that is not in accordance with general accepted accounting principles, and that is they would create what were called cushion reserves.

In good years, they would set aside contingent liabilities and keep those liabilities in a rainy day slush fund, and that's what these X files were.

At the end of 1996, they had a significant bad debt shortfall, and what they did is they applied about seventeen and a half million dollars of cushion to the problem. They simply used these contingent liabilities,

wrote off account receivables against them, the bad debt, says where it is, and there is no need to expense any bad debt, and they don't have to show an enormous operational loss on the financial statement.

Now, they say we didn't know about this, but the problem is -- they didn't know about this memo, but the problem is, No. 1, there's nothing about that memo that kept them from doing an audit.

More generally, as we point out in our papers, our forensic auditing experts have opined in this case that nothing AHERF's management did or did not do impaired Coopers & Lybrand from either detecting the misstatements or performing a GAAS, Generally Accepted Auditing Standards, sufficient audit.

As we say in our brief, that really is the end of the analysis because it means there is a jury question, therefore, as to whether or not there truly was the kind of audit interference they're talking about.

But the point is they knew that AHERF's eastern operations were badly under reserved for bad debt. The audit work papers show, as we point out in the statement of facts and in our brief, truncated audit procedures by them, what one of our experts refers to as a hot stove. They would do various independent tests to determine the reasonableness of the reserves and then those

tests would stop.

The audit engagement partner ultimately says we came to the conclusion they were $15 to $20 million short on their bad debt reserve in the eastern hospitals, what are called DV or Delaware Valley, and told them so.

We thought they were short about $15 to $20 million. There is no work paper evidence about this $15 to $20 million. There is no indication anywhere where he came up with those numbers.

However, these people who were talking on the television screen, Mr. Adamczak and Mr. Spargo, indicate, and so told Coopers when they came in after the fall, or PricewaterhouseCoopers when they came in after the fall of AHERF to try to resurrect what had happened here, is that everybody knew, including Coopers & Lybrand, that even after that $15 to $20 million shortfall was taken care of, there was still $30 million short in DV, and Coopers notes of those interviews, indicates this is per Mr. Adamczak, indicated a decision was made at a closing meeting that '96 AR reserve was $30 million under reserved, and to take it in over three years. Done at a closed meeting, all hands, including C&L.

Now, that's a violation of Generally Accepted Accounting Principles. Our experts have testified they won't dispute that you're not allowed to fix bad debt in

little drips and drabs and to leak it into the financial statement over three years.

So when they say that Mr. Cancelmi's recognition in memos they were under reserved for bad debt constitutes audit interference, there is a jury question here about whether or not the failure to impart that memo materially interfered with their audit.

In addition to that and apropos of the Court's question, we have the question of the Graduate reserve transfers.

I mentioned this whole concept of these cushion reserves and what AHERF did is in connection with the acquisition of some hospitals in late '96, ultimately folded into AHERF in May of 1997. What they did is they created a whole variety of purchase accounting reserves under principles of purchase accounting for liabilities that they might have to face at the Graduate Hospitals, which were the hospitals they were acquiring over the short term.

Now, under purchase accounting they have to resolve the issues of these contingent liabilities in a short period of time. They're not allowed to just leave them there forever, but that wasn't a problem to AHERF because as their in-house folks testified to, they were creating those reserves in large part or if not created in

large part, quickly became seen as a vehicle to address an even worsening situation with Delaware Valley, bad debt reserves, and by the end of 1997, they had transferred $99 million of these reserves to the Graduate to address their bad debt problems primarily.

Now, Coopers & Lybrand's argument about audit interference is they knew about the first $50 million and they knew that it was, as they say in their brief, a departure from GAP. That means they knew in connection with the 1997 audit, they transferred $50 million of these reserves from the Graduate over to DV, and they knew it was a violation of GAP, but they claim in the briefs to the Court, and it's a big argument they had, we didn't know about the other $49 million, that makes up the total of $99 million.

Now, the significance of this is because in connection with the $50 million of reserves that they knew about and knew were a quote, unquote, departure from GAP, they claim through a series of convoluted reasoning they don't bore the Court with in their summary judgment brief, they claim it did not somehow result in a material misstatement of AHERF's financial statements, never mind the Generally Accepted Audit Standards and Accounting Procedures require them to inform the board of so-called reportable conditions relating to the integrity or honesty

of AHERF's management.

This management that they say lied to them, they lied to them. They knew he transferred $50 million of reserves. They knew it was a violation of GAP, and they nonetheless claim they had no obligation with regard to that because it did not result, they say, in a material misstatement of the 1997 financial statement; but once you get another $49 million lopped on to that, now you're going to have a lot of trouble selling that one.

So their basic argument is they didn't know about the other $49 million of reserves. In their brief to the Court, they cite these various bullet points of the things that supposedly AHERF did to conceal from them the fact of the $49 million of reserves, but, in fact, there is a memo in their file dealing with one of those reserves of the $49 million. In fact, it represented about 30 percent of that number, $14 million.

It's on the Court's screen, and it is showing there as a PFMA contract. Now, this is a memo of Pricewaterhouse. It's got their Bates number on it, and discovery establishes that the handwriting we're looking at here is the handwriting of one of the audit managers in the case, Mark Kirskein.

Now, they would probably argue I'm putting this up here because I love this memo, and I would answer

you're right, I do like this memo because it tells you a lot about how much of a group of lanny-pies (phonetic) these Coopers & Lybrand auditors were and how much they were really taken in by this supposed audit interference.

This was part of the $49 million they didn't know about. The note to the immediate right says where did it go, and then over, attached over to an arrow, not through income moved to DV reserves for AR. Moved to Delaware Valley reserves for accounts receivable.

The same meeting was attended by another audit manager of Coopers, one Amy Frazier. There is the same memo. Here are her notes. Reserves reported in SDN legal documentation indicates that GMS is obligated. That is on that contract, the entity that acquired the Graduate Hospitals is obligated on that PFMA contract. Transferred reserves of the books to DV, Delaware Valley. This is $15 million of the $49 million they now claim they didn't know about, and those memos indicate nothing other than the fact they absolutely did know about it.

They were looking for it in the course of their audit. Where is the PFMA contract, and they were being told where it was.

These are examples of the evidence we put before the jury in response to their little bullet point arguments about whether or not these guys knew about this

other $49 million of reserves, or whether or not anything we did materially interfered with their ability to find out whether we did or we did not.

As I said at the outset, this is not the kind of case where audit interference really has a role. Once, again, whether it does or it does not is a jury question.

The last thing I wanted to talk to you about as it relates to their summary judgment is the issue of proximate causation.

Now, in their brief, and this is an argument I have seen before, they characterize proximate causation is woulda, coulda, shoulda testimony, and they also speak in terms of the idea that our causation case is this carefully constructed series of things that the Court has to find in order to find that there was a causal link between the negligence and the damage.

This is all it comes down to. Coopers & Lybrand knew or should have known at the time they issued a clean opinion on the 1996 AHERF financial statements that they were materially misstated and not by a little bit.

They were off by a cool $90 million here in 1996. Instead of showing an excess of revenue of profits of something under $10 million, they actually should have shown a loss of close to $80 million, and that's all coming from the Delaware Valley primarily, and that matters.

It matters to the overall story because as I said earlier, the Delaware Valley supposed success, you know, their ability to take these losers and turn them into winners through synergy was what was fueling their acquisition program and also helping out a lot with the incentive compensation packages, that's what it should have said.

Coopers & Lybrand should have issued not a clean opinion but an adverse opinion on their financial statements saying the financial statements showing that this company has an excess of revenue over expense does not fairly present the financial statements in accordance with GAP.

Now, no one has ever seen adverse financial statements, and the reason is anybody who needs one can't suffer an adverse audit opinion, and, therefore, ultimately, what it does is it gives AHERF or Coopers ultimate leverage to force this management to accurately record what the financial statement position of the company was or inform the board what the evidence was or what the actual financial position was.

We have presented testimony of board members that if this kind of disclosure had been made, it would have had an impact. They would have had to have explored options available to them, including such things as hiring

a consultant, firing management, considering whether or not to stop the acquisition program, deciding at that point in time not to buy the Philadelphia hospitals then under scrutiny, undertaking a turnaround program.

All of those things were what members of the audit committee have testified to, and that is in our statement of facts.

Now, our position is if that kind of intervention had occurred, we have testimony that says that if the things they said they would have explored and would have been forced to do in that situation had been done, AHERF would not have suffered an ultimate loss to its creditors, and AHERF, therefore, could have either stayed in business but would not have had a creditor loss.

Now, their argument is it's hypothetical, it's hypothetical, it's hypothetical because it didn't happen. The answer is yeah, I know it didn't happen.

A lot of times tort laws, proximate cause is about things that didn't happen, and the Courts have recognized that that kind of testimony passes muster in a circumstance like this to prove intervention; and in fact, one of the cases that we cite to you speaks in terms of the fact that the very fact that it is hypothetical in nature --

THE COURT: I think a better word than

hypothetical is they're saying it was speculative.

MR. WHITNEY: I'm not drawing lines. I have proven these cases one or the other. The bottom line is it passes muster.

By urging the Court to refuse consideration of this deposition testimony, this is Commeau versus Rupp, the accountants failed to recognize the plaintiff's proof of causation in this case is rendered more difficult by the very nature of the claims.

Negligent omissions on the part of defendants that in turn caused inaction on the part of the RCSA board, because this necessarily poses the causation question of what would have happened if the accountants had adequately fulfilled their duties.

It is difficult to understand how the FDIC could prove its case without at least some of the testimony that the accountants derided as self-serving and speculative. To accept the accountant's argument would allow them to profit from an uncertainty of their own creation, notwithstanding the elementary conceptions of justice and public policy require that the wrongdoer shall bear the risk of the uncertainty which his own wrong has created.

They talk about options they would have been forced in that situation to perform. One of the things

that cases look at that is pretty important here, whether one calls it hypothetical or speculative, what happened when the truth came out because what happened in the summer of 1996 almost immediately after the board finally heard about the Graduate reserve transfers, these are the things that Mr. Butner, the partner in charge, said 50 million of it was a departure of GAP.

He said I advised my manager to tell them to reverse those entries. That statement is not in the audit work papers, and he signed the financial statement, even though the reserve transfers were not reversed.

What is significant, the board asked him in a June 1998 meeting, Coopers engagement partner, the audit committee asks him what's going on with these $99 million of reserves being transferred. His answer, forthcoming as it was, is I don't know what you're talking about. I don't know what you're talking about.

When they found out what they were talking about, they fired him almost immediately. They fired Abdelhak, they fired McConnell. They hired a turnaround expert. That turnaround expert indicated by that time it was too late. He also indicated, as had ours, that if this had occurred at an earlier point in time, year end 1996, the company could have been saved.

That testimony adds to this supposed woulda,

coulda, shoulda testimony. It also answers this case they like so much from the D.C. Circuit called Drabkin versus -- I have forgotten what the name of the defendant is. I've forgotten.

There the Circuit Court of Appeals set aside a jury verdict based upon the fact that the weight of the evidence indicated that the causation case advanced by the plaintiffs was not sufficient.

They pointed out there that for two years prior to the supposed misstatements and the supposed hypothetical intervention, the company had received from the auditors going concerns, opinions, expressions by the auditor as part of their opinion they had doubts as to the ability of the company to continue as a going concern, which they ignored.

That circumstantial evidence drove the D.C. Circuit to say this causation case doesn't pass muster, and I don't have a problem with that case at all.

As a matter of fact, I take comfort from a case like that because what that is showing is even in this Drabkin case that they like so much, there is a recognition that an auditor's opinion can and in the appropriate case should be held to call for an intervention, and there the intervention or the information the accountant gave was information that absolutely if they're not going to

intervene, they never would, but that's not the evidence in AHERF.

By the way, in Drabkin, they claim -- I don't know why they claim this -- that Drabkin stands for the proposition this woulda, shoulda, coulda testimony has to come from the majority of the board, 35 or more on AHERF board, including Teresa Heinz Kerry was on the board but not deposed in this case. There is nothing in Drabkin about that.

The plaintiff's evidence was characterized by the Court of Appeals as having been a sound bite from one director suggesting that if disclosures had been made, they would have done something. The Drabkin case does not undercut our position. Proximate causation is a question of fact.

I'm just about at the end, so let me speak briefly about the CitX case. First of all, there's a holding in CitX that says something like negligence alone will not support a cause of action for deepening insolvency. I was a little surprised to hear the discussion of that holding today.

We didn't bring a cause of action for deepening insolvency. I don't know what a cause of action for deepening insolvency is. I don't know what it looks like, and I also know not for nothing Judge Fuentes was to

the contrary notwithstanding that Lafferty intended to create a cause of action, at least as the term has been used, by practicing members of the bankruptcy Bar in the Third Circuit.

What Lafferty was dealing with, which is relevant, I guess to the question of CitX, is Lafferty was dealing with an adage that the accounting firms have raised in the past going back to a 7th Circuit case in the 1980s, which we cite in our brief, called Shock against Brown.

Creditors have very limited standing to sue auditing firms of a debtor. Generally speaking, if the debtor or the auditing firm does not essentially specifically intend to extend the representations of their audit to an individual creditor, that creditor doesn't have individual standing.

The argument was made by Coopers & Lybrand in this Shock against Brown case, which dealt with the insolvency of the American Reserve Insurance Company that because of that fact, once a company becomes insolvent, the corporation no longer suffers any injury because once it hits a net worth of zero and goes below that, you're talking about only a creditor injury, and the Seventh Circuit said in Shock that's not true.

The deepening insolvency of a corporation is also stating a corporate harm. What Lafferty is doing in

part is following Shock in the Third Circuit in this opinion, but I guess because Shock against Brown was an insurance liquidation and not a bankruptcy and, therefore, had a smaller audience, nobody thought to create or try to argue that Lafferty created or Shock created a cause of action; but in the wake of Lafferty, there is all kind of case law out there, guys running around bringing causes of actions against management and auditing firms for deepening insolvency, without even any kind of traditional allegations of wrongdoing.

Our case pleads negligence. It is a state law tort claim, and we allege that they were negligent, we allege proximate cause, and we allege alternative theories of damage.

I was interested to hear Mr. Rafferty indicate that one of those theories of damage was just knocked down. What CitX says is invalid because it couldn't be more unlike CitX.

When they filed a motion for summary judgment here, they also filed a motion to strike our damages, which were, one, creditor shortfall predicated on the evidence that, one, if they had discharged their duty as auditors, there would have been an intervention, and we can prove by a preponderance of the evidence that that intervention would have saved this company from loss, so the unpaid

obligations to creditors, which is an injury under Shock against Brown and Lafferty, is on them.

Alternatively, they should be at least liable for what are the avoidable losses. These are specific transactions you can point to that wouldn't have happened if there had been an accurate disclosure of their financial statements and there had been the consequent intervention.

Proof by a preponderance of the evidence of identifiable transactions that would not have happened. Those were our theories of damage, and the motion they filed was those theories of damage are invalid because they don't measure a deepening insolvency. The suggestion that was made was the only damages you can get are damages that are allowed under Lafferty, and our response was huh.

This is a state law tort action with state law proof of proximate cause and state law proof of damage because in Pennsylvania, as everywhere else, that law is damages are intended to be put down and a plaintiff is entitled to recover damages that would put them in the position they would have been in were it not for the defendant's wrongdoing, and that's what our damages were. They said that was illegal because they weren't deepening insolvency damages.

If you look at the motions they filed at that time, they argued that we didn't even prepare balance

sheets comparing --

THE COURT: To be fair to Mr. Rafferty, you have to wrap up.

MR. WHITNEY: The bottom line is where they come out on CitX is this. They are not suggesting that our damages are like those in CitX. They are saying CitX bars deepening insolvency-like damages, and CitX specifically does not say that.

What CitX says, and this is the critical language of the opinion, if I can put my hands on it, where an independent cause of action gives a firm a remedy for the increase in its liability, the decrease in fair asset value or its lost profits, then the firm may recover without reference to the incidental impact upon the solvency calculation.

In other words, don't come into court claiming I had my insolvency wrongfully deepened. Don't come into court proving the very damage measure that they claimed is the only damage measure available.

Look at our balance sheet here, look at our balance sheet there, because a lot of things can cause a change in that balance sheet; but if you have common law tort claims and common law tort damages, you can recover them notwithstanding the incidental impact on the solvency calculation because we, the Third Circuit, sitting in

diversity, they don't say this, but it's a fact you can't be rewriting Pennsylvania tort law.

Thank you, Your Honor. I appreciate your patience.

THE COURT: Thank you, Counsel.

MR. RAFFERTY: Thank you, Your Honor.

THE COURT: I'll be in touch.

(Whereupon, the above argument was concluded.)

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I hereby certify by my original signature herein that the foregoing is a correct transcript from the record of proceedings in the above-entitled matter.

S/ Karen M. Earley

Karen M. Earley, RDR-CRR

Official Court Reporter